LOUISIANA-PACIFIC
PULPWOOD AGREEMENT No.10
COMPLIANCE REVIEW
(Clause 3.01)

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Preface

This has been a difficult review. Despite this, all parties: Louisiana-Pacific; contractors; suppliers; complainants; and the Ministry of Forests staff provided the fullest cooperation in supplying written and verbal information and in various physical inspections.

The conclusions and recommendations contained in this report are based on information gleaned informally from pertinent documents and personal interviews. The findings here represent our considered judgements as professional foresters based on the facts presented to us. At no time do we purport any legal interpretation of the material we have gathered as that would be both beyond our competence and terms of reference.

EXECUTIVE SUMMARY

Sterling Wood Group Inc. was retained by the Minister of Forests early in 1990 to conduct a compliance review of Pulpwood Agreement #10. After a long period of dispute concerning the terms of reference the review commenced in June of 1990. The basic issue concerns compliance with Clause 3.01 of the Agreement.

The Pulpwood Agreement document is patterned on preceding PAs concerned with residual chip supplies and is deficient in its definition of "reasonable", etc, as it relates to the purchase and harvest of pulpwood for which PA 10 is actually intended. This has required us to assume a definition of "reasonable", particularly in terms of purchase pulpwood prices.

We have assumed that reasonable in terms of price in the present context, can be measured by a comparison of purchase prices with costs that LP would incur in logging similar pulpwood stands on Timber Sale Licences awarded to LP under the PA. Further, we have assumed that these costs can logically be based on the traditional Ministry of Forests measure of the "average efficient operator".

Analysis of these costs and prices based on appendices as attached, is presented in the report.

On the basis of these definitions we have concluded that, in the narrowest sense, there has been compliance with the letter of the document in terms of price as set out in Clause 3.01 of the Pulpwood Agreement, but we detect a deviance from the spirit of the agreement. There is an insignificant difference of less than 1% between purchase prices and experienced efficient costs, including stumpage.

On the basis of the company having taken all measures "reasonably necessary to obtain from other sources the total raw material requirements of the Mill ... ", again in the narrowest sense, in our opinion there has not been strict compliance because certain suppliers continue to be excluded from selling pulpwood because of past affiliations and actions. There is a legal issue here on which we are not qualified to comment further.

Having stated the above, we are compelled to point out that there is great difficulty with this measure of price fairness. The difficulty is that the company, by whatever means, has achieved contract logging costs (required here to measure the efficient alternative to purchases) which are unreasonably low by contemporary industry standards and in terms of a fair margin for profit and risk. Consequently, although it apparently meets the test, the purchase price is low. In our opinion neither contractors nor suppliers are receiving an adequate return but the test of compliance seems to be met. A suggested alternative equitable pricing mechanism is presented in this report.

The above situation is aggravated and confounded by the direct issue to the company of Timber Sale Licences under the Pulpwood Agreement at an extremely low statutory stumpage rate. The result is that the company obtains an admirably low raw material cost but at the expense of inadequate returns to contractors, suppliers and the Crown. The test price formula tends to be inadequate because stumpage is too low.

A number of recommendations are made throughout the text of this report for improvements to various administrative processes by all parties. In addition several specific policy options for consideration by government to alleviate the inadequacy of the pricing process are presented separately near the end of this report.

Briefly these include:

1. Providing a more stringent control of available Crown timber supplies.

2. Directly influencing the establishment of price.

The exercise of appropriate policy options would not only resolve the existing financial dispute but could go a long way toward dispelling the acrimony and mistrust that prevails in the community.

1.0 INTRODUCTION

Sterling Wood Group Inc. was retained to conduct an audit of Pulpwood Agreement #10[1] according to the terms of reference contained in Appendix I of this report. The audit resulted from complaints in the Dawson Creek locality that clause 3.01 of the Pulpwood Agreement was not being fairly applied.

1.1 The Issue

The issue arises from a "strike" by a group of suppliers in 1989. This complainant group has alleged that Louisiana-Pacific is not in compliance with clause 3.01 of Pulpwood Agreement #10. They allege that the price offered for pulpwood[2] by LP is too low and that the company's wood supply purchasing policy is discriminatory because certain members of the complainant group are excluded from selling pulpwood to LP. The complainants further allege that the company employs a favoured group of contractors who received preferential treatment through negotiated prices to deliver Crown timber allocated by the Government to the company at nominal stumpage while all other suppliers are relegated to a single category of suppliers at a single price.

The company contends that prices are fair and that an efficient contracting sector is essential to maintain efficient costs and reliability of delivery. LP further contends that many smaller suppliers are unbusinesslike and unreliable and that pulpwood deliveries cannot be wholly dependant on such suppliers because of failure to fulfil contract deliveries in the past. LP also contends that withholding of supply by the complainant group is evidence of refusal to supply and that this is sufficient reason to refuse further supply from them. The issue has been contentious, divisive and confrontational in the community.

1.2 The Pulpwood Area Tenure History

Pulpwood Harvesting Agreements (PHA) were developed in the early 1960's. They were intended to provide emergency assurance of raw material supply to pulp mills in the event residual chip supplies were unavailable. This situation has never occurred in the PHAs held by pulp companies. PHAs were converted to Pulpwood Agreements in the 1979 Forest Act.

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1. Issued to Louisiana-Pacific Panel Products Ltd. Dawson Creek, B.C. on Sept. 18th, 1986.

2. Pulpwood in this report refers exclusively to poplar species. It is generally termed aspen except where it refers specifically to black poplar which is identified by name.

Recently the Pulpwood Agreement (PA) has been employed as a method of timber allocation. PA 10 is an example of this, and as the first on which harvesting has actually occurred, is a test of the "fairness" of the pricing mechanism for pulpwood.

1.3 PA 10 Agreement

PA 10 was issued to Louisiana-Pacific (LP) on September 15, 1986. A copy of the Agreement and a summary of certain relevant timber inventory information relating to it are contained in Appendix II of this review.

The Agreement is modelled on previous PAs, hence it contains reference to "wood residues". In the case of Louisiana-Pacific, **"residues"** are meaningful only in the context of residual pulpwood since the mill requires a wafer of a very different design from a conventional pulpwood chip to produce its product of oriented strand board (OSB). There is no outside supplier of wafers at the present time. In this regard see clause 7.01(i) of the agreement for the definition of wood residue.

Two clauses in the Pulpwood Agreement relate to the current dispute. They are vague and open to various interpretations.

Clause 2.01 refers to cost of raw material delivery in residue form by owners of timber processing facilities. By extension, if this is interpreted in the context of this particular tenure also to mean "pulpwood", it provides some guidance regarding reasonable price.

> *"... the costs, including delivery costs to the mill, that would be reasonably incurred by the Company to harvest roundwood timber in the pulpwood area, to deliver it to the Mill and to produce suitable wood residues from it."*

Clause 3.01 also in part refers to residues and states:

> *The company may not exercise its harvesting option under paragraph 1.01 unless ... (b) The company has taken all measures that are reasonably necessary to obtain from other sources the total raw material requirements of the Mill..."*

The clause lists sources as:

- Pulp timber from within the pulpwood area or suitable wood residues produced by the company or its affiliates.

- Pulp timber from within the pulpwood area offered by others at reasonable prices.

- Suitable wood residues from outside the pulpwood area offered by others at prices not exceeding the costs that would be incurred by the company to harvest and deliver roundwood timber in the pulpwood area and to produce suitable wood residues from it.

A Ministry of Forests memo (see Appendix VII) also provides guidance for definition of "reasonable price" as follows:

> *"That is, a reasonable price would be the cost, including logging and hauling costs, that LP would incur if they were to log the timber. It should not mean some sort of average cost or the cost LP might incur on some area closer to the manufacturing plant".*

We have concluded that the reference to delivered wood residue costs in clause 2.01, that would **"be reasonably incurred"** within the PA, can logically be linked to the pricing structure referred to in clause 3.01(b) as the offered price **"reasonably necessary"** to obtain non-company purchased pulpwood supplies.

1.4 Reasonable Price Definition

On the basis of this linkage, we have analyzed and derived a reasonable logging cost allowance in the PA and used this cost as a reasonable offer price for purchased wood. The cost components included are:

- loaded-on-truck costs
- hauling costs
- development and other costs
- allowance for profit and risk
- stumpage

These are costs that would be incurred by an average efficient operator. This measure has traditionally been employed by the Ministry of Forests to test reasonableness of costs for stumpage appraisal purposes and is employed here. It implies costs based on the average of efficient operations, not all operations.

2.0 METHODOLOGY AND APPROACH

Reviews were made of:

- Background files pertaining to the issues prior to this audit.
- PA #10 document.
- Transcripts of public hearings.
- LP Management & Working Plan.
- LP Five-Year Development Plan and SBFEP five-year plan.
- LP's 1988 and 1989 Annual Reports to the Ministry of Forests.
- Logging contracts and costs.
- Logging sites and conditions in the field.
- LP's mill yard, scale, and mill.

Discussions over four days were held in Dawson Creek with:

- LP personnel.
- IWA representatives/complainant group spokespersons.
- Ministry of Forests personnel.
- Logging contractors.
- Other pulpwood suppliers.

A one-day field trip to review the logging sites was conducted by Sterling Wood Group personnel (R.S. Wood; J.C. Bartlett) and Ministry of Forests District Manager, Dawson Creek (R. Gibbs).

Detailed verification of material obtained during and after the trip was made by telephone, fax, mail and additional file review in Victoria. A comprehensive analysis process followed this.

The report first addresses the analysis of reasonable price and its components and then turns to additional issues, including demand and supply factors, and Ministry of Forests policy which can affect such pricing.

Unless otherwise noted, dollar figures are based on 1989 statements, and we have used the year 1989 as a base for determining costs and prices. These would obviously be subject to adjustment for future application.

3.0 LOGGING COSTS AND PRICE ISSUES

3.1 Issues

The basic issue to be addressed first is whether or not LP is making reasonable efforts at a reasonable price to obtain all available outside pulpwood and wood residue supplies. As noted, we have concluded that the definition of a reasonable price is that which the company would incur on a similar site within the PA as the seller. We have further employed the concept of the average efficient operator to apply this definition. That is, a reasonable price would be the cost incurred by an operator who is mid-way on the scale of efficient operators in terms of equipment, management and productivity plus a reasonable allowance for profit. Other issues including market factors and Ministry of Forests policy are addressed later in this report.

3.2 Logging Costs Issues

On the basis of the above, logging costs were studied in PA 10 and compared with those experienced on similar operations on similar sites. In this review the cost issues were classified as: Hauling Costs; Development and Other Costs; Loaded-on-Truck Costs; Stumpage; Profit and Risk; Log Quality Specifications; Scaling and Conversion Ratio.

3.2.1 Hauling Costs

General

Louisiana-Pacific has devised a log hauling rate based upon an average distance and a breakdown of the cycle time (see Appendix III). This formula yields unrealistically low values in many situations. The following comments are offered regarding the formula:

Road Configuration

The travel speed employed is based upon a 15 percent ratio of secondary roads to highway roads travelled. A sample of contracts indicates the percentage of secondary roads is an average of 30% (see Table 1 - Appendix IV). This has the effect of decreasing the cycle time unrealistically.

Unloading

A 30 minute unloading time allowance was assumed by Louisiana-Pacific. Past experienced times have been influenced by chronic delays in unloading at the mill. Recently this problem has been addressed by Louisiana-Pacific with improved yard equipment and methodology. They have achieved their target of 30 minutes during the summer of 1990; however this time may change for winter deliveries. Yard time is largely controlled by the company and the onus is upon Louisiana-Pacific to evaluate this correctly in the formula.

Contractor versus Private Supplier Hauling Costs

Contractors on LP Timber Sale Licences obtain adjustable hauling rates based on distance and/or cycle time. Pulpwood from other suppliers receives only a single rate regardless of distance. This is an obvious inconsistency in delivered price equity. The fixed maximum rate of $6.50 per tonne for hauling private pulpwood has been established by LP. This includes all outside sources including the Crown Small Business Forest Enterprise Programme (SBFEP). Under this formula, pulpwood beyond 40-45 km and/or a 2.5 hour cycle time for a five-axle truck is subject to delivery at a price below cost.

Previously Louisiana-Pacific had two rates for delivered private wood, based upon haul distance divided into two categories.

Zone	Distance (km)	Rate ($/tonne)
1	0 - 50	20.20
2	50 +	23.02

The haul distance criterion reasonably reflected a rate difference of $2.82/tonne, however this attempt to establish equity among haul distances was unsuccessful. In this regard the company contends that the two price system was abused by some suppliers delivering Zone #1 wood represented as Zone #2 supply. Presumably this could be eliminated by relatively simple supervision of timber marks and field operations.

A comparison of our estimated incurred haul cycle times vs Louisiana-Pacific formula cycle times is presented in Table 1 - Appendix IV. LP's cycle times were calculated using their format (Appendix III) and the estimated incurred times were obtained through discussion and verified by on-site observation. This indicated that LP's calculated time has under-estimated incurred time by an average of 29%.

The average cost per tonne Louisiana-Pacific has calculated is 24% less than our estimate of incurred costs (see Table 2 - Appendix IV). Massie et. al. (1990)[3] produced haul costs by distance in a study in Dawson Creek in 1989 and their costs were interpreted in Table 2 for the sampled contracts. Massie's costs are 16% greater than Louisiana-Pacific's costs but are still lower than our estimate of incurred costs. This difference may be explained by the fact that, in Massie's study, all truck configurations were averaged, whereas our estimate of "Incurred" costs were defined by truck configuration. The amount of influence of Louisiana-Pacific data within the Massie study is unknown; nevertheless, both our estimated incurred costs and Massie costs indicate a shortfall in trucking rates. The slow unloading time in LP's yard, as noted, contributes considerably to this cost differential.

The data in the tables in Appendix IV was not collected in a truly random fashion from all operations but from operations over a range of distances. They are therefore not precise but are simply indicative of the order of magnitude of differences.

In our opinion the rate established by LP, expressed in dollars per tonne per hour, is reasonable. The problem is that the estimated cycle time used in the pricing formula is not reasonable.

Recommendations:

1. The inconsistency of hauling rates between Louisiana-Pacific Crown contracts and private supply contracts should be eliminated. Hauling should be considered a separate cost item in all contracts, regardless of the origin of the wood within the PA boundary. If it is appropriate to negotiate Louisiana-Pacific Crown contracts, then it is appropriate for private purchases too.

   However, this is not to imply that the company should be compelled to purchase all available pulpwood regardless of distance. This would unduly penalize LP. Appraisal trucking rates should simply be similar for TSL operations under the PA and other operations within the same approximate distance limits outlined in a current LP 5-year Management and Working Plan.

2. Rates should be based on the cycle time for an average truck configuration, and payload.

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[3]. Massie, M., E.B. Peterson, R.D. Kabzems. 1990. An Economic Strategy for Managing Aspen on Private Lands in Northeast British Columbia. Table 15. FRDA Rep. #24. Forestry Canada, Victoria, B.C.

3. A reasonable cycle time and average truck payload should be determined for each contract. This is a relatively simple matter which can be based upon experience and information from adjacent logging sites. Once estimated, it should be verified by the use of scale load slips, which should be sampled using a systematic but random format. This procedure would also accommodate for seasonal differences, yard time, road conditions, and travel speeds.

3.2.2 Development and Other Costs

Development is defined as road construction and maintenance to the site that is being logged. It is not part of the cost of mobilization, demobilization, nor roads and landings on the site, as these are included in the Loaded-on-Truck phase. Other costs refer to special contract conditions such as slash disposal, pasture requirements, or landing rehabilitation which are efficiently and logically performed by the contractors.

Road and Bridge development costs in the PA 10 area are estimated to be $0.50 - 0.75/tonne. These are expected to rise as the accessed and short-haul wood diminishes. Development and Other costs are not being recognized for private purchases. The Development & Other costs are between 2 - 5% of the Loaded-on-Truck cost. Indications are that for LP TSL contracts the Development and Other costs are averaging $0.75/tonne while for private contracts we estimate these costs to average $0.40/tonne.

Subsequent silviculture costs necessary to secure a new crop are negligible on all categories of tenure in the aspen types in this area.

Recommendation:

Development and Other costs supplementary to normal on-site costs should be accounted for in a fair and consistent manner among all contracts, as additions to the Loaded-on-Truck costs.

3.2.3 Loaded-on-Truck Costs

LP employs an internal cost schedule for pricing purposes. Logging costs were calculated for "Minor" contractors (10,000 tonnes per year) and "Major" contractors (40,000 tonnes per year). These cost schedules were developed internally by the company (see Appendix III).

LP calculated a cost of $11.90 per tonne for major contractors and $11.67 per tonne for minor contractors. These cost allowances are substantially lower than actual costs evident elsewhere and are lower than those indicated in published studies. Massie et. al. (1990) collected logging costs in the Dawson Creek area for felling, skidding, bucking, and loading phases. Their data indicate minor contractor costs to be $12.70/tonne and those of major contractors to be $12.45/tonne (at a 1.05970 m^3/tonne conversion ratio). If "on-block" development (i.e., landings and spur roads) costs are included at $0.75/tonne, the costs from Massie et. al. (1990) become $13.45 and $13.20 for minor and major contractors respectively (Table 3 - Appendix IV). The average, weighted by a ratio of 30:70, approximates $13.25/tonne. Using LP's figures of $0.55/tonne, the Massie et. al. (1990) data becomes $13.25 and $13.00, and the average becomes $13.07.

Table 4 - Appendix IV indicates our determination of the Loaded-on-Truck costs derived from LP's delivered prices less incurred Hauling, Stumpage, and Development and Other costs. The Crown contracts are 7% lower than the total of Loaded-on-Truck data collected by Massie and Development and Other costs for Major contracts. The private contracts are 17% lower than the total for Minor contract data derived from Massie et. al. (1990)

Table 4 also shows that the average total cost of wood to LP from TSLs issued under the PA is almost identical to the average total price of wood delivered by private suppliers. This is an important observation fundamental to determining compliance with the Pulpwood Agreement.

A significant portion (10% historically, with 27% planned in the future) of the private wood supply is from the SBFEP on TSLs which are logged to the same Ministry of Forests standards as LP TSLs within the PA. SBFEP costs are more directly comparable to contractors on Crown land with respect to Development & Other costs. Operators on private land can reduce their costs by about $0.25-0.50/tonne, if they allow their logging standards to fall below those of the Ministry of Forests, and perhaps compromise the ability of their lands to support future crops.

Recommendation:

1. Loaded-on-Truck costs should be established at a base average of $13.25/tonne (1989 dollars) and adjusted, plus or minus, according to site factors such as terrain, volume per hectare, or season of logging. Development and Other costs should be added to the Loaded-on-Truck rate.

3.2.4 Stumpage

Private stumpage on private land is generally $2.00/tonne plus a $0.04/tonne scaling fee for a total of $2.04/tonne. SBFEP timber sales "upset" stumpage is $0.50/$m^3$ ($0.53/tonne) and it is commonly bid up to $2.00. Louisiana-Pacific stumpage to the Crown is fixed at $0.50/$m^3$ ($0.53/tonne), which is $1.50/tonne less than commonly occurring private and SBFEP stumpage rates.

Private suppliers' delivered pulpwood price is inclusive of logging costs and stumpage. This situation places the private wood suppliers (including SBFEP timber sale holders) at a disadvantage to the Louisiana-Pacific Crown wood suppliers. That is, the Crown supplier is paid for Loaded-on-Truck and Hauling costs, at a negotiated rate, exclusive of stumpage. Louisiana-Pacific has a tolerance of $1.50/tonne in this calculation, due to the differences in stumpage between the PA rate and the other Crown and private rates.

The statutory stumpage rate of $0.50/$m^3$ obtained by LP in the PA pervades the issue because this low rate is used in the price compliance test. The Crown may have been required to set such a rate as an investment inducement but once set it ties all other suppliers' price to this low rate. The effect is to reduce the return to all log suppliers. Any increase in the statutory rate would implicity increase private pulpwood prices because of the working of the compliance test for "reasonable" price.

3.2.5 Profit and Risk

Profit and Risk (P&R) is an allowance added to delivered wood costs exclusive of stumpage to provide a margin to cover interest costs, incentive and general re-investment to maintain efficiency. It is a standard component in determining logging contract prices. The P&R allowance was assumed as 10% by Louisiana-Pacific (Appendix III) in their logging cost calculations.

Two very efficient major operations were estimated to be generating 8-9% P&R prior to the recent price decrease (see Section 3.2.8). It is surmised that an efficient minor contractor is attaining 4 - 5% P&R. Clearly these are insufficient returns to maintain a healthy business.

Recommendation:

We suggest that a fair profit and risk allowance for the average efficient operator be established as a minimum of 10% of realistic costs exclusive of stumpage.

3.2.6 Log Quality Specifications

The log quality specifications employed by the company are precise, strict, and clearly explain the importance of quality criteria. LP employs a quality sampling programme which is specific to each contract. The standards do not specify the technique for selecting quality samples except that Ministry of Forests sample loads are also monitored for quality. Also the standards do not always specify the monetary deduction made for infractions.

LP's quality specifications are presented in Appendix V. Briefly, a quality rating of less than 98.2% is subject to a monetary deduction per tonne that applies on all deliveries until the next sample (normally one sample per 25 loads per supplier). A quality rating of less than 97% is subject to an additional fine for the load received and two load deliveries less than 95% may result in contract cancellation.

Species delivery is also restricted. Because of manufacturing factors, LP is compelled to limit the delivery of black poplar to 20% of total deliveries.

3.2.7 Scaling and Conversion Ratio

The Ministry of Forests supervises the scaling procedures at the LP mill site. Together with LP personnel they establish the intensity of sample loads required to be hand-scaled to determine the ratio of the volume to weight (m^3 per tonne). This is required for Ministry of Forests control of the amount of wood cut by LP (from their B.C. sources only) and for billing the amount of stumpage due by LP on their TSLs.

LP maintains separate strata for private B.C. deliveries and for LP TSL (Crown) deliveries. Table 5 - Appendix IV indicates almost the same number of samples are taken for 70% of the volume as for 30% of the volume. This seems strange when the populations being sampled can be expected to be quite similar.

We have examined the conversion ratio for the two strata, and, while there is a difference between them, it is not large. There does not appear to be any cause for concern in any case because LP's price formula is based entirely on tonnes not m^3.

3.2.8 Delivered Pulpwood Costs and Purchase Prices

LP offered to purchase all private wood at a uniform base price of $21.10/tonne in the summer of 1990. This represents an increase of $0.60 from the previous rate of $20.50/tonne. In August 1990 market conditions prompted LP to reduce the price of all its supplies, Crown and private, by $1.05/tonne (5%). Private delivery price is now set at $20.05 for an unspecified time.

Delivered wood costs include the following basic components:

Hauling	Loaded-on-Truck
Development & Other	Stumpage

We estimate that by normal industry standards a reasonable cost for these components would average $22.79/tonne. This is based upon a 52 km haul, which was the average distance of the contracts sampled. Costs representing several variations in haul distance, stumpage, and Development and Other costs are presented in Table 8 - Appendix IV for comparison purposes.

There is a difference in treatment between negotiated contracts for PA deliveries of Crown timber and fixed price private deliveries. The Crown contractors have the benefit of negotiating contracts to accommodate variability of cost components. LP Crown wood contracts have an arbitration clause, "Purchase Orders" for private wood suppliers do not have this opportunity. Moreover, Crown contracts exclude Stumpage, because the company pays it directly. However, the price for private deliveries must include an allowance for stumpage because the seller must pay the stumpage.

Recommendations:

1. All supply contracts, private or Crown, should be negotiated on a delivered basis using a consistent format.

2. The delivered cost components of Hauling, Loaded-on-Truck, Development and Other (inclusive of Profit and Risk), and Stumpage should be clearly categorized independently and combined into a final appraised delivered price. The Loaded-on-Truck phase should work from a base of $13.25/tonne. The Hauling cost should be calculated separately and based upon realistic cycle time, truck rate and payload.

4.0 MARKET FACTORS AND POLICY ISSUES

In economic terms an ideal market is one in which there are many buyers and many sellers. Under these conditions a true market price is attained. The further conditions depart from this configuration the more the price is skewed up or down depending on the disproportionate strength of the sellers or the buyers. In the case of PA 10 there appears to be a situation where there is a surfeit of sellers.

4.1 Demand and Supply Factors

Louisiana-Pacific is virtually the only buyer of deciduous pulpwood in the Dawson Creek area. The company therefore entirely controls the demand component of the local market.

Pulpwood supplies originate from several sources (see Tables 6 and 7 - Appendix IV).

4.1.1 Private Lands

Alberta

By virtue of its geographic location LP is able to obtain a portion of its wood supply requirements from private lands in Alberta. In 1989 this totalled approximately 57,000 tonnes or 11% of LP's plant needs.

British Columbia

There is a very large inventory of aspen species pulpwood, on private lands in the Dawson Creek area. Pulpwood is produced from these lands during agricultural clearing operations or as straight-forward harvesting operations. Operations are conducted directly by the land owner, through contract logging or through third party agreements. The 1989 Private Timber Mark volume was about 235,000 tonnes or 46% of LP's plant needs.

4.1.2 Crown Lands

Pulpwood supplies originate from a variety of categories of Crown tenures.

Pulpwood Agreement #10

PA 10 technically allows Louisiana-Pacific to harvest up to 452,000 m^3 of

pulpwood annually provided all other sources have been exhausted through the offer of a "reasonable" purchase price. In 1989 the company harvested 141,167 tonnes or 27% of the mill needs. The company harvests this supply through efficient contractors from Timber Sale Licences awarded to LP without competition under the Pulpwood Agreement.

Small Business Forest Enterprise Programme

Annually the Ministry of Forests auctions a series of Timber Sale Licences under this programme. Pulpwood originates from sales which are either predominantly aspen species and are intended for pulpwood production or from sales which are intended for coniferous species production but contain an aspen pulpwood component, the harvest of which is mandatory. The effect of this is to require the supplier to subsidize aspen delivery at the expense of the coniferous component. Up until now the SBFEP has supplied 9% of the mill's needs.

The 1990-1994 5-year Plan of the Ministry of Forests for this programme has set a cut of 120,000 m^3 which will represent an increase to 27% of LP's wood supply originating in B.C. if it is to be entirely consumed by LP.

Licences to Cut

The Ministry of Forests issues Licences to Cut to persons purchasing or occupying lands but do not have the right to harvest Crown Timber. This tenure is generally associated with land clearing operations on agricultural land under the jurisdiction of the Ministry of Crown Lands. It is also commonly issued to petroleum companies for their construction and exploration projects. In 1989 the delivery was approximately 36,000 tonnes or 7% of the mill's needs.

4.1.3 Wood Residues from Other Timber Processing Facilities

This potential source of raw material is mentioned because it is specifically addressed in Clause 2.01 of the PA. At present there is no actual supply of "logging residue, slabs, edgings or wafers" being offered to the mill. No other operator within the pulpwood area has a waferizer and slabs and edgings are normally chipped and sold as chips to pulpmills. To our knowledge no timber processing facility has attempted to offer logging residue to the LP plant.

4.2 Policy Factors Affecting Delivered Pulpwood Price

The timber supply situation in the Dawson Creek area is unique in B.C.. There is a large supply of suitable Crown timber combined with a huge concentration of private land also containing a large supply of suitable private timber.

Government forest policy generally, and administration of PA 10 specifically, can have a huge impact on pricing by virtue of the influence of these factors on the balance of available timber supply. The issue giving rise to this audit is not simply a dispute between buyers and sellers. If all the available supply were privately owned the problem would not exist for government. This is not the case, however. Government is unavoidably an involved and responsible agency in the issue as well. The more supply the government makes available from the PA, the more the market opportunities for private suppliers diminish and some degree of control in the market by the Crown becomes virtually unavoidable.

There is only one buyer: LP, and the same buyer also has a very strong position as the major supplier by virtue of PA 10. The PA allows the company easy access to a highly flexible supply of Crown timber at low statutory stumpage. The understandable incentive is to use this supply access as a planning and price control mechanism. Any other astute company would do the same, given the opportunity. The problem is that the Crown has a responsibility in the process because it controls the rate of availability of Crown timber in the PA. Excessive allocation of this Crown supply can skew the market.

Table 7 - Appendix IV, indicates the wood supply balance for timber coming from B.C. Factors to note are: the planned B.C. supply through LP TSLs is 32%, and the planned B.C. supply through the SBFEP is increased to 27%.

4.3 Policy Options

There are various policy and administrative options available to government to influence pulpwood prices if it chooses to do so. These fall into two general categories.

4.3.1 Control of Available Crown Timber Supply

Control direct access to PA timber supply by requiring a rational and stringent proof of "need" prior to allocation of TSLs. Such proof could be subject to a price test based on realistic cost appraisal data.

Control supply provided under the SBFEP by limiting the number of predominantly aspen sales made available and by removing the subsidy of aspen by coniferous species by making aspen non-competitive and its utilization optional, where it is a minor specie. Make the utilization of black poplar optional in all cases.

Raise the proportion of timber supply made available in the SBFEP and lower that in the PA to provide a higher competitive component in the Crown supply component.

4.3.2 Influence or Arbitrate Price

Establish a tribunal system similar to that, for example, in Quebec. In this, the tribunal consists of a lawyer and two independent technical experts and employs legal process such as right to Counsel.

Raise the statutory stumpage price for aspen on TSLs issued under the PA.

5.0 SELECTIVE EXCLUSION OF SUPPLIERS

In 1989 a group of suppliers affiliated with IWA-Canada was dissatisfied with the price that LP offered and elected to withhold further supply to the mill until their grievance was addressed. They contended that LP was not in compliance with clause 3.01 of the agreement, the contention that finally led to this review.

This withholding of supply was interpreted by LP to be a breach of contract by these suppliers. The company quickly made arrangements with others to fill the gap. The protest failed to influence LP and the group sought to continue to supply pulpwood, albeit at LP's contentious price. LP refused to accept deliveries from certain members of this group claiming that the group had broken their contracts, other contracts had been signed to replace them, and LP was unable to void these new contracts.

We do not comment here on whether or not the company is legally correct. We have noticed however that the company appears to be using the situation that arose to discriminate against selected suppliers. Some of the group have been allowed to return in one way or another as suppliers, others are still refused. This situation has led to a high level of acrimony in the community, not only between suppliers and those who work for LP, but also between suppliers who protested and suffered and those who did not.

LP were able to maintain a continued allocation of 30% of their timber from the PA. Whether the group of dissatisfied suppliers was right or wrong, they had no chance of influencing LP, given the ironclad alternative options available to LP, by virtue of their being the sole consumer and the holder of a PA.

6.0 CONCLUSIONS AND RECOMMENDATIONS

Although we conclude that, in the strictest sense, there is compliance in terms of price with clause 3.01 of PA 10, returns to all suppliers are inadequate.

On the basis of our analysis of the information available, the price offered by the company for purchased pulpwood is low by $0.25 - $2.50/tonne depending on haul distance and other factors noted in the report.

Ministry of Forests policy has contributed to the surplus pulpwood supply situation as noted in the report, by allowing a planned non-competitive access to Timber Sale Licences by LP in the PA, now meeting more than 30% of the mill's needs. Furthermore the availability of aspen pulpwood through the SBFEP has been accelerated and utilization of aspen, where it occurs as a minor species on SBFEP coniferous Timber Sale Licences, is mandatory. The effect has been to diminish market opportunity for private suppliers of pulpwood and hence price.

As long as the company is provided planned, direct, non-competitive access to Crown timber through the PA the "reasonable" pricing issue will remain contentious. A clearer price resolution mechanism will be required not only for PA 10 but also for other possible PAs where the agreement provides for obvious allocation of timber supply. Although a degree of flexibility of supply access is essential to LP for orderly planning, efficiency and inventory management, such ready access to Crown timber should not be used as a purchase price control mechanism.

This review arises from a highly contentious situation. A group of suppliers chose to take collective action (in effect a strike) to obtain higher prices. This action failed. The company used this withholding of supply to exercise its option to obtain alternative supply in the PA. Within limits this was a prudent and required action from a point of view of wood supply planning. In effect both sides were partly right. The price issue was focused by the complainant group and the supply access issue by LP.

Our conclusion is that in the interests of compliance with clause 3.01 of the PA, future access to the market should be available to all suppliers regardless of affiliation, provided all contractual conditions are met.

Since the Ministry of Forests appears to be inescapably involved in the pulpwood market through its planning of Crown Timber supply availability, it is virtually inevitable that it will continue to be involved in the pricing issue.

In our opinion a more systematic price monitoring mechanism than, for example, this review is required. Alternatively a more rigidly planned Crown timber supply policy for the PA and the SBFEP could be implemented to assure a more competitive situation between Crown and private timber supplies. Finally, if it chooses, the Crown can automatically increase private pulpwood prices simply by increasing the statutory stumpage rate in the PA.